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**Memorandum**  
From the office of  
**Commissioner Andy Tobin**  
**Arizona Corporation Commission**  
1200 W. WASHINGTON  
PHOENIX, ARIZONA  
(602) 542-3625

TO: Docket Control

DATE: May 17<sup>th</sup>, 2016

FROM: Commissioner Andy Tobin's Office

SUBJECT: Docket#W-00000C-16-0151

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Commissioner Tobin submits the attachment to the above-referenced matter which includes Statements of Policy developed by a group of state agencies and private organizations for the Commission's consideration at the May 19, 2016 Water Workshop.

Arizona Corporation Commission

**DOCKETED**

MAY 17 2016

DOCKETED BY	<i>[Signature]</i>
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**BEFORE THE ARIZONA CORPORATION COMMISSION**

**COMMISSIONERS**

DOUG LITTLE – Chairman

BOB STUMP

BOB BURNS

TOM FORESE

ANDY TOBIN

Arizona Corporation Commission	)	
Investigation into Potential Improvements	)	Docket No. W-00000C-16-0151
to its Water Policies	)	

**Arizona Corporation Commission**

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona Administrative Procedures Act. If this substantive policy statement is believed to impose additional requirements or penalties on regulated parties, then the agency may be petitioned under A.R.S. § 41-1033 for a review of the statement.

**Policy Statement on Small Water System Emergencies**

Arizona and the rest of the American Southwest are in the midst of 21-year drought with no relief in sight.<sup>1</sup> According to a recent study by researchers from the National Center for Atmospheric Research, weather systems bringing moisture to the Southwest are becoming rarer, and the new normal in the region “is now drier than it once was.”<sup>2</sup> Another study concluded that the chances of a “megadrought,” or a drought lasting 35 years or more, are between 20 and 50 percent.<sup>3</sup>

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<sup>1</sup> Drought - Arizona State Climate Office. (n.d.). Retrieved May 12, 2016, from <https://azclimate.asu.edu/drought/>

<sup>2</sup> Prein, A. F., G. J. Holland, R. M. Rasmussen, M. P. Clark, and M. R. Tye (2016), Running dry: The U.S. Southwest's Drift into a Drier Climate State, *Geophys. Res. Lett.*, 43(3), 1272–1279, doi:[10.1002/2015GL066727](https://doi.org/10.1002/2015GL066727)

<sup>3</sup> Ault, T. R., J. E. Cole, J. T. Overpeck, G. T. Pederson, D. M. Meko (2014), “Assessing the Risk of Persistent Drought Using Climate Model Simulations and Paleoclimate Data,” *Journal of Climate*, 27(20), 7529-7549, doi: [10.1175/JCLI-D-12-00282.1](https://doi.org/10.1175/JCLI-D-12-00282.1)

Extremely dry weather has converged with the long-known over allocation of Colorado River water supplies. Since the early 2000s, water levels at Lake Mead, where river water is stored for Arizona, California, Nevada, and Mexico, have declined by as much as 12 feet a year.<sup>4</sup> The Bureau of Reclamation projected last month that the water level at Lake Mead by year's end will be just three feet above the 1,075-foot shortage declaration level that would trigger significant reductions in water deliveries to all states except California. For comparison, Lake Mead was approximately seven feet above the trigger level at the beginning of 2016.

This longer term trend has made way for a potential tri-state water agreement between Arizona, California, and Nevada, which would result in immediate cuts in Central Arizona Project's supply of river water to all sectors of Arizona that rely upon CAP water for drinking and irrigation. These cuts would shift water users to local water supplies. Further, even if this pact were accepted and adopted by each party, the water levels are still projected to decline, albeit at a much slower pace. Fortunately, Arizona has led the nation in groundwater replenishment and is prepared, but that doesn't mean the state and especially small water companies are out of the woods, nor does this mitigate the reduced availability of surface water as result of prolonged drought.<sup>5</sup>

In addition to drought, water quality also poses a tremendous financial burden to Arizona water providers. There are currently 71 drinking water standards that the EPA mandates as part of the 1974 Safe Drinking Water Act regulations. The Environmental Protection Agency Drinking Water Infrastructure Needs Survey projects water treatment improvements to cost

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<sup>4</sup> Davis, T. (2016, April 23). Big CAP cuts coming as 3-state water agreement nears. *Arizona Daily Star*. Retrieved from <http://www.tucson.com>.

<sup>5</sup> Arizona Department of Water Resources. (2014). *Arizona's Next Century: A Strategic Vision for Water Supply Sustainability*. p. 14.

\$72.5 billion over the next 20 years.<sup>6</sup> The cost of cleaning water will have an especially acute impact on smaller water providers given the limited customer base to pay for expensive water treatment technologies.

Simply put, Arizona faces a sobering water future: “The end of the ‘cheap water’ era....[and the beginning] of a world in which water is more scarce, more valuable, and more expensive.”<sup>7</sup> CAP shortages will entail increased reliance on local water supplies, undoubtedly affecting the aquifers many small, rural water companies rely upon to sustain the communities they serve. The cost curve to operate a water system will bend significantly upward as wells will need to be drilled deeper and pumps will need to be larger and more powerful. Looming infrastructure investments to combat drier conditions and new environmental regulations, replace crumbling pipes, and upgrade the capacity of systems to reflect population growth will require highly sophisticated managerial, fiscal, and technical prowess. This paradigm shift will cause many small water companies to become troubled and many troubled small water companies to fail.

In a good number of cases, consolidation might provide the best hope for a financially sustainable water company that offers superior service to the public at reasonable rates. Chairman Little’s workshop revisits this sticky wicket that has wracked the Commission since 1998—at least that is how far recent memory reaches back. The Water Task Force convened by then-Chairman Jim Irvin, provided a blue print of policy guidance for Commission Staff to pursue over the next decade.<sup>8</sup> In 2010, the Commission investigated other mechanisms that

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<sup>6</sup> U.S. Environmental Protection Agency: Office of Water. (2013). Drinking Water Infrastructure Needs Survey and Assessment Fifth Report to Congress. EPA 816-R-13-006, Washington DC 20460.

<sup>7</sup> Quinn, P., P. Walker (2014). The Challenges of Consolidating an Industry. p. 19. Docket No. WS-00000A-14-0198.

<sup>8</sup> Decision No. 62993 (November 3, 2000). Docket No. W-00000C-98-0153.

could encourage the acquisition of troubled water companies and ultimately adopted a policy statement that provided guidance to Commission Staff regarding treatment of income tax expenses for tax pass-through entities.<sup>9</sup> Former Chairman Susan Bitter Smith, reopened the consolidation discussion in 2014, which generated many ideas that are before the Commission today.

Missing in 1998, 2010, and 2014 is a clearer acknowledgment that, in certain cases, consolidation will either not be a feasible concept for some troubled companies or that it will occur after the troubled company fails. What should be the Commission's response in those instances? The attached policy statements seek to answer that question in part. Below is a summary of each statement.

#### *Water Emergency Team*

On April 25, 2016, a group of representatives from state government and the water industry met to discuss the formation of a Water Emergency Team (WET) and other challenges plaguing small water systems. The group met again on May 5th and May 12th. These meetings were predicated on the water emergency of the Citrus Park Water Company in Tacna, AZ. The community lost water service after the water table dropped due to nearby irrigation. Because of the efforts of the company's Interim Manager (IM), Nancy Miller, and other private citizens, along with Yuma County Supervisor Russ Clark, Commission Staff, and the Department of Environmental Quality, limited water services were restored nearly a week later.

Citrus Park is a tragic story that has come to define the purpose of WET and the vision of where the state should be in terms of immediate-, short-, and long-term policymaking for small

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<sup>9</sup> Decision No. 73739 (February 22, 2013). Docket No. W-00000C-06-0149.

water companies. The failure of Citrus Park might be attributed to a variety of factors including system abandonment by the owner several years ago (which has yet to be resolved), mechanical problems with the well pumps, and environmental realities of more stringent water quality regulations coupled with reduced local water supply.

Citrus Park revealed serious gaps in what should be a coordinated approach to an emergent water crisis. We learned that there were no clear protocols on which organization would lead the state's response, including a determination of whether an emergency existed, a health and welfare check of the residents affected, an engineering visit to the system to classify the severity of the problem, the communication with nearby water providers to help restart service, or an evaluation of emergency rates or other options like interconnections with nearby systems as viable actions to resume water service.

The simple question of, "Who picks up the phone when emergency strikes?" was surprisingly difficult to answer at the initial WET meeting.

WET is designed to provide greater coordination among state agencies and industry officials in cases where a water emergency (e.g., a water outage or contamination of water in excess of environmental standards) poses an imminent threat to public health and safety. This goal was discussed by the Regulatory Reform Subcommittee of the 1998 Water Taskforce but no action was taken at that time.<sup>10</sup> Policy Statement No. 1 defines WET, formalizes the Commission's participation in the team, and gives guidance to Commission Staff on how to interact with it. *(For more information, please see Attachment A.)*

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<sup>10</sup> Residential Utility Consumer Office (1999) [Appendix]. In Arizona Corporation Commission, *Interim Report of the Arizona Corporation Commission's Water Task Force*. (p 18). Docket No. W-00000C-98-0153.

*Administration of the Small Water Systems Fund*

The Small Water Systems Fund (SWSF) was created by the Legislature in 2006 to provide emergency grants to troubled small water companies with a Commission-appointed Interim Manager (IM) for the repair or replacement of water infrastructure. According to a September 2015 Commission Staff Report, the SWSF disbursed \$705,572 to nine water systems between FY 2007 and FY 2010. After the remaining monies in the SWSF were transferred to the General Fund in 2010, no additional emergency grants have been awarded.<sup>11</sup>

Clarity is a core tenet of an efficient process. To that end, the Commission endorses Policy Statement No. 2 that will clearly delineate how troubled small water companies can be eligible for SWSF monies. New to this policy statement is a directive to Commission Staff to notify the Commissioners, the Water Infrastructure Finance Authority Board, and WET whenever an SWSF emergency funding application is submitted, along with continued notification throughout the SWSF process.

Additionally, Policy Statement No. 2 endorses the concept of Commission Staff collaborating more extensively with troubled water systems to appoint an IM, thereby granting access to the SWSF long before complete system failure occurs. While the Staff Report notes that “funding from the SWSF will help restore operations in short-run emergency....a sustainable long-term solution is beyond the scope of the SWSF,”<sup>12</sup> Policy Statement No. 2 encourages Commission Staff to recommend SWSF funding, when possible. *(For more information, please see Attachment B.)*

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<sup>11</sup> Arizona Corporation Commission (2015). In the Matter of the Commission’s Inquiry Concerning Possible Solutions and Funding Mechanism for Small Water Companies. p. 1 (footnote 3). Docket No. W-00000C-15-0250.

<sup>12</sup> *Ibid.* p. 4.

*Simplifying Regulatory Burdens on Class D and E Utilities*

Policy Statement No. 3 addresses the need of Commission Staff to engage small water systems as soon as practicable and educate them on the purpose and importance of compliance items, such as the annual reports, and provide easy-to-follow steps (and one-on-one guidance if needed) on how to fulfill these regulatory obligations.

But this policy statement goes further. The Commission directs Staff to work with the Water Utilities Association of Arizona and the Rural Water Association of Arizona to evaluate adopting less burdensome regulations for small water companies with revenues of \$500,000 or less. Commission Staff should focus on simplifying the rate case process and annual reporting requirements. One reform might be reducing the rate case time frame to 90 days for small water companies with revenues of 500,000 or less. *(For more information, please see Attachment C.)*

*Streamlining Emergency Rate Cases and/or Surcharges at the Commission*

Between 2006 and 2016, water companies filed 18 applications for emergency rates with the Commission. For those applications that made it through the entire process, it took an average of 133 days per case. Either the emergency designation is a misnomer or the process is seriously in need of reform. Policy Statement No. 4 directs Commission Staff to promulgate a real emergency process that can process a company's application, from start to finish, within 30 days. *(For more information, please see Attachment D.)*



*Establishing a Commission Ombudsman for Small Water Companies*

Both RUCO and Arizonans for Responsible Water Policy included this recommendation in their May 8, 2014 white paper because “many small water companies have demonstrated very significant challenges interpreting and navigating the Corporation Commission’s rate case process.”<sup>13</sup>

Policy Statement No. 5 directs the Executive Director to produce a proposal using existing Commission resources that would establish and fill the Small Water Ombudsman office with the necessary staff to assist small companies with various Commission processes and conduct extensive outreach with small water companies, especially companies that have had their Certificates of Convenience and Necessity revoked. *(For more information, please see Attachment E.)*

**ORDER**

IT IS THEREFORE ORDERED that the Commission adopt the following policies in accordance with A.R.S. § 41-1091:

- A. Policy No. 1 as it relates to the Water Emergency Team;
- B. Policy No. 2 as it relates to the Small Water Systems Fund;
- C. Policy No. 3 as it relates to reducing the regulatory burdens on water companies with revenues of \$500,000 or less;
- D. Policy No. 4 as it relates to streamlining emergency rate cases/surcharges;

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<sup>13</sup> Quinn, P., P. Walker (2014). The Challenges of Consolidating an Industry. p. 23. Docket No. WS-00000A-14-0198.

E. Policy No. 5 as it relates to the creation of an Small Water Ombudsman Office for Class  
E water utilities.

IT IS FURTHER ORDERED that the Commission Utilities Division and Legal Division shall post the attached policy statements on the Commission's website in accordance with A.R.S. § 41-1091.01 and publish policy statements (or a summary thereof) in the Arizona Administrative Register in accordance with A.R.S. §41-1091(A) and 41-1013(B)(15).

**POLICY STATEMENT NO. 1  
WATER EMERGENCY TEAM  
STATEMENT OF POLICY**

1. The Commission officially recognizes the collaborative working group known as the Water Emergency Team (WET) that is designed to develop protocols and potential regulatory and statutory changes that will provide immediate, short-term, and long-term relief to troubled water providers.
2. The Commission is aware that WET has defined “emergency” to mean an imminent threat to public health and safety, which includes an outage of water service and water contamination in excess of maximum contaminant levels as promulgated and/or implemented by the Arizona Department of Environmental Quality.
3. The Commission is aware of the following organizations participating in WET and expects additional organizations to be added as needed:
  - a. Arizona Department of Environmental Quality;
  - b. Arizona Department of Water Resources;
  - c. Arizona Water Infrastructure Finance Authority;
  - d. The Department of Emergency and Military Affairs;
  - e. Arizona Commerce Authority;
  - f. County Supervisors Association;
  - g. Water Utilities Association of Arizona; and
  - h. Rural Water Association of Arizona.
4. The Commission endorses the WET concept and directs Commission Staff to participate fully in WET.
5. The Commission appoints the Utilities Director, or designee, along with the Manager of Consumer Services, to be members of WET.
6. In order to strengthen the relationship between the Commission and WET, the Commission shall designate a sitting Commissioner to be a member of WET with the eventual goal of the Commission annually considering a Commissioner designee.
7. If any rulemaking is necessary for the Commission to fully participate in and share information with WET, then the Commission directs Commission Staff to initiate a rulemaking to adopt rules to implement this policy.

**POLICY STATEMENT NO. 2**  
**SMALL WATER SYSTEMS FUND**  
**STATEMENT OF POLICY**

1. The Commission directs Commission Staff to process applications for emergency monies from the Small Water Systems Fund and make an appropriate recommendation to the Commission within 10 business days.
2. Once Commission Staff receives an application for emergency monies from the Small Water Systems Fund, the Director shall transmit to the Commissioners, the Water Infrastructure Finance Authority (WIFA), and all members of the Water Emergency Team (WET) a summary of the request.
3. Upon receipt of Commission Staff recommendation, the Commission will seek to hold a meeting as soon as practicable to discuss and possibly vote on the recommendation.
4. The Commission directs Commission Staff to collaborate with WET and WIFA in determining the most efficient workflow for processing Small Water Systems Fund applications.

**POLICY STATEMENT NO. 3**  
**SIMPLIFYING REGULATORY BURDEN ON SMALL WATER COMPANIES**  
**STATEMENT OF POLICY**

1. The Commission directs Commission Staff to collaborate with the Water Utilities Association of Arizona and the Rural Water Association of Arizona to evaluate a simpler and more streamlined Annual Report for all Class E water utilities and Class D water utilities with annual revenues of up to \$500,000. The Commission further directs Commission Staff to report back to the Commission with an appropriate recommendation by August 31st, 2016.
2. The Commission directs Commission Staff to collaborate with the Water Utilities Association of Arizona and the Rural Water Association of Arizona to evaluate simpler and more streamlined rate and financing case processes for all Class E water utilities and Class D water utilities with annual revenues of up to \$500,000. The Commission further directs Commission Staff to report back to the Commission with an appropriate recommendation by August 31st, 2016.

**POLICY STATEMENT NO. 4**  
**STREAMLINING EMERGENCY RATE CASES/SURCHARGE APPLICATIONS**  
**STATEMENT OF POLICY**

1. The Commission directs Commission Staff to collaborate with the Water Utilities Association of Arizona and the Rural Water Association of Arizona to evaluate the Commission's current processing times for Emergency Rate Cases and Emergency Surcharges and report back to the Commission by September 30th, 2016 with an appropriate recommendation that allows a water company to receive a Commission vote on an emergency rate case or surcharge within 30 days after filing. The recommendation should include, if necessary, rule changes.

**POLICY STATEMENT NO. 5**  
**CREATION OF COMMISSION SMALL WATER OMBUDSMAN OFFICE**  
**STATEMENT OF POLICY**

1. The Commission directs the Executive Director to create within the Utilities Division a Small Water Ombudsman Office, consisting of an accountant, lawyer, and engineer, for all Class E water utilities and Class D utilities with up to \$500,000 in annual revenues to assist these companies in preparing and filing rate and financing applications, along with other compliance filings, as well as help evaluate long-term planning in infrastructure, acquisition, etc.
2. The Commission encourages the Small Water Ombudsman Office to conduct outreach as soon as practicable to small water companies in operation that have had their Certificates of Convenience and Necessity canceled or that are out of compliance with the Arizona Department of Environmental Quality or the Arizona Department of Water Resources.
3. The Commission directs Commission Staff to report back to the Commission by the November 2016 Open Meeting on the status of these companies and necessary action plans for these companies to resolve compliance issues.
4. The Commission directs Commission Staff to initiate a rulemaking to adopt rules, if necessary, to implement this policy.